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SENSITIVE

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TAGS: ECON EWWT EINV RP
SUBJECT: Floundering Philippine Shipping

SENSITIVE BUT UNCLASSIFIED

¶1. (SBU) Summary: Despite its 7,000 islands, the Philippines has a small and uncompetitive domestic shipping industry. Restrictive maritime policies and inflexible financial regulations suit special interests, but block opportunities for growth and modernization of the sector. Initiatives to implement international standards have been largely unsuccessful. The underdevelopment of this sector negatively affects U.S. efforts to promote economic development throughout the country, especially in the peripheral regions that depend heavily on domestic shipping, such as Mindanao. End summary.

Underdeveloped Shipping Industry

¶2. (SBU) The Philippine Domestic Shipping Development Act of 2004 provides operators with investment incentives that include VAT exemption for purchases of vessels above 150 tons, carryovers for net operating losses, accelerated depreciation to minimize taxable income, etc. Although business leaders initially thought the Act would bring long-sought impetus to development of the industry, subsequently, it became clear that the legal framework of the Philippines still seriously hinders growth of the shipping industry. The structure of the domestic cabotage law (exclusive right of a country to wholly regulate its coastal waters) limits foreign investment while strengthening local cartels; banking and financial regulations make it difficult for operators to finance new vessels, or for new companies to enter the market; and interference from the court system impedes maritime development projects.

Cabotage Law: Here to Stay?

¶3. (SBU) Like many countries, the Philippines has a protectionist cabotage law that bars foreign-owned ships from domestic routes. However, the effects of this law in the Philippines are particularly damaging since only about a dozen major shipping lines control nearly all domestic shipping, and collude with each other to divide routes and set prices. In the Philippines, cartelization is government policy since the government encourages the shipping operators to meet regularly in order to collaborate on pricing issues and division of routes. This practice has resulted in excessive domestic shipping costs which greatly retard the economic development of peripheral areas of the country which depend on domestic shipping for virtually all commerce. Mindanao businesspeople are especially hurt since most of their trade involves heavy use of cabotage to the central and northern islands.

¶4. (SBU) However, the major shipping lines strongly resist changes or liberalization of the existing regime and employ their considerable political influence to keep the industry closed to competition. There is also relatively little outside pressure to change the status quo, since it is not unusual for foreign shippers to be excluded from domestic shipping.

¶5. (SBU) Maritime Industry Authority administrator Vicente T. Suazo defends the current domestic shipping regulations and told Embassy officers that the Philippines is not ready to lift it or further liberalize until local operators modernize their fleet to international standards, even though it is unclear if or when this will ever happen. Recent executive orders focus on modernization through shipbuilding and retirement programs for aged vessels. The current phase-in/phase-out program aims to retire 1,500 vessels while replacing them with 625 new ones by 2010. To support the phase-in/phase-out, new vessels can be financed through the National Maritime Leasing Corporation under the Medium-Term Development Plan of the National Economic Development Authority.

But Unattractive Financial Options Hamper Development
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¶6. (SBU) The leasing terms offered by the National Maritime Leasing Corporation include a fixed interest rate of 7% to 15% with mandatory repayment in 7 years and no grace periods. Few local operators find these conditions attractive and most prefer to finance their ship purchases with loans from abroad. Josephine G. Uranza, Vice President of Magsaysay Inc., one of the largest maritime corporations in the Philippines, told Embassy officers that the unfavorable financing options explained why there are few new ships on domestic routes.

Judicial Interference Also a Problem

¶7. (U) Domestic port facilities also need upgrading. A new program awards leases to private firms who plan to build new facilities to

accommodate larger vessels, cargo, and passengers. The lease allows full foreign ownership of ports for 25 years plus an option to renew for another 25 years. Interested firms apply to the Board of Investments. At least two competing firms must pass the vetting process in order for one to win the lease. Winning firms are granted tax breaks and other incentives dependent upon the amount of the investment and/or how pioneering their plan.

¶8. (SBU) However, Philippine courts interfere in the outcomes of the lease awards. An example is the case of North Harbor port in Manila, the Philippine's largest domestic port. Only one firm, Harbour Centre, passed the initial vetting process therefore voiding their bid since two firms are required. Harbour Centre then sued. The court case is currently pending and is expected to last another six years. Until a ruling, no further bids can be entertained, leaving North Harbor in a neglected state. General Manager Sevilla of the Philippines Port Authority told Embassy officers that judicial interference is a big problem and efforts to modernize port facilities under build-operate-transfer schemes also face the frequent legal challenges and slow decisions that characterize the Philippine judicial system.

¶9. Comment: The inability of the Philippines domestic shipping industry to modernize hinders U.S. efforts to promote economic growth in the Philippines, especially in peripheral regions. The U.S. has placed particular emphasis on developing Mindanao's agricultural base, but if Mindanao cannot ship its products at affordable prices, the scope of business with other parts of the Philippines will be limited. Maritime reforms could help achieve economic growth in the periphery regions of the Philippines through modernizing the domestic shipping industry. End Comment.

KENNEY